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Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Comments on Proposed Rule: PCA – Risk-Based Capital

Dear Sir:

I am a former banker and relatively new member of Arlington Federal Community Credit Union. Since this first experience, I'm totally convinced that the credit union model of management by and for member-owners is a vastly superior approach to financial services. As a result, I have severed all of my ties with for-profit financial institutions – cards, checking, loans, safety deposit, CDs, everything. You could say I have the zeal of the newly converted. It's in this spirit that I write about the NCUA's proposed rule on risk-based capital (RBC).

As a former banker, I appreciate the logic of RBC: It is self-evident that some loans are inherently riskier than others and that capital retention is a requirement of responsible lending. That said, RBC is only one of an important array of risk management tools and a limited one at that. By ignoring the other side of the balance sheet, a poorly conceived or overly aggressive RBC rule can interfere with responsible, effective asset-liability management. In addition, RBC is always an inefficient and ineffective tool for addressing interest rate, concentration, and liquidity risk.

RBC can provide an extra level of security against the marginal challenges of managing credit risk for certain asset classes, but only if the rule is narrowly-targeted, consistent, and efficient. Unfortunately, the NCUA proposed rule appears to be none of these things. Instead, it seems designed to discourage and even punish effective institutional management by penalizing credit unions for being too good at doing certain things, even if those things are exactly what their member-owners want, need, and have a right to expect.

The proposed rule also contradicts NCUA claims for it, which boil down to promising regulatory equity with banks, but with adjustments to better fit the credit union model. In fact, in virtually every instance, the proposed rule is more restrictive and more expensive than the bank equivalent, putting credit unions at a significant competitive disadvantage relative to banks. If the American Bankers Association itself drafted this rule, it is hard to imagine how it could be more harmful to the interests and legitimate rights of credit unions and their member-owners.

Since I know the ABA did not write the proposed rule, I can think of only three possible explanations for the inconsistencies and illogic of this proposal:

1. *The NCUA believes that it does not have the ability to supervise and examine the full array of basic credit union lending activity and is using this rule to discourage activity beyond its competence.*

   Obviously, this cannot be the case. NCUA examiners are the best paid in the business, so I expect they are also the best trained, best supported, and most capable.

2. *The NCUA believes that credit unions are exceptionally bad risk managers and represent excessive danger to the credit union system and to the taxpayers whose fall-back deposit guarantee ultimately stands behind them.*

   This is demonstrably false. Alone among financial institutions, natural person credit unions came through the recent financial crisis with shining colors, not having cost the American taxpayer a single penny. In one asset class in particular, home mortgages, credit unions had a default rate (and foreclosure/eviction rate) that was only a small fraction of that of banks, thrifts, and other lenders. These facts, in the midst of the worst financial crisis of modern times, indicate that credit union assets generally, and credit union mortgages specifically, should have a risk-weighting schedule lower than those of other regulated financial institutions. The proposed rule has things upside down.

3. *There is something inherent to the credit union model that creates more risk.*

   This is the most nonsensical of all the options. The credit union model is inherently LESS risky than the banking model. "Credit unions are different" has become almost cliché, but it is true. And what makes credit unions different is their ownership structure and its impact on risk-taking. Banks are systemic risk takers, obligated to take the greatest risks possible in order to enrich their equity stockholders. They do this by exploiting the conflicts of interest between customers, owners, and regulators. The credit union model, on the other hand, involves no conflicts of interest because there are no third-party owners trying to enrich themselves on the backs of their customers. Credit union customers and owners are one and the same, so the inherent risk-taking is circumstantial – external to the system – and therefore significantly lower and more benign in aggregate.

By every measure, credit unions take on less risk than their bank counterparts and they manage it better. A rational RBC rule would recognize and reward these facts. The proposed NCUA rule does the opposite. It seems designed to grant bankers their fondest wish by making the credit union model untenable.

Withdraw this rule. It is not needed. If withdrawal is not an option, then wholesale overhaul is absolutely required, as is another round of review and comment on what should be a heavily revised version.

Respectfully submitted,

Christopher O. Howard